IN THE CHANCERY COURT FOR DAVIDSON COUNTY, TENNESSEE
PART I

SENTINEL TRUST COMPANY, and its Directors, Danny N. Bates, Clifton T. Bates, Howard H. Cochran, Bradley S. Lancaster, and Gary L. O'Brien,	)	
Petitioners,	)	
VS.	)	NO. 04-1934-I
KEVIN P. LAVENDER, Commissioner Tennessee Department of Financial Institutions,	)	
Respondent.	)	

MEMORANDUM AND ORDER

This is a case involving a challenge to the actions of the Commissioner of the Tennessee Department of Financial Institutions in using his emergency powers to take possession, without prior hearing, of the petitioners financial institution on May 18, 2004. The petitioners also challenge the subsequent decision to liquidate. The petitioners challenged the emergency seizure and subsequent liquidation by filing a petition for writ of certiorari on June 29, 2004.

The Commissioner acted to take possession and then to subsequently liquidate Sentinel because he contended that "Sentinel had used pooled fiduciary funds to provide operating

capital for non-related defaulted bond issues, thereby creating a fiduciary cash shortfall that greatly exceeds Sentinel's current operating capital and that Sentinel has failed to reconcile fiduciary cash and corporate cash accounts in a timely and accurate fashion and to keep accurate books and records." For the reasons stated herein, the Court affirms the decisions of the Commissioner and dismisses the petition.

Sentinel Trust Company provides fiduciary services as trustee and/or fiscal agent, bond registrar, and paying agent for various types of corporate and municipal bonds. The president and C.E.O. of Sentinel is Mr. Danny Bates and Mr. Bates and his wife own 90-95% of the stock. Most of the Board members are related by blood or marriage to Mr. Bates. As a financial institution, Sentinel Trust Company operates under the regulatory control of the Department of Financial Institutions.

This Court held an initial hearing on August 5, 2004, and issued a twelve-page memorandum and order denying the petitioners' request for a writ of supersedeas. After subsequent proceedings, which will be explained below, the Court held a final hearing and heard proof and argument on March 29, April 1, and April 4, 2005. The Court then took the case under advisement to study the record and render a final decision.

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This is a convoluted case. Just how convoluted will become apparent in this opinion as the Court outlines the chronological development and procedural turns.

The Commissioner exercises regulatory authority over financial institutions, including Sentinel Trust Company. Like all governmental regulators of financial institutions, he is charged with insuring the stability of such institutions. He is empowered to issue cease and desist orders and, in some extreme cases, to take possession of a financial institution and to liquidate. In some cases, the Commissioner cannot act to take possession until after the responding institution is given a hearing, but in an emergency situation, the Commissioner can take possession without a prior hearing subject to a subsequent hearing. The two (2) applicable provisions of the law are at T.C.A. §§ 45-2-1502 (a) and (c)(1) as follows:

> **45-2-1502. Commissioner in possession** - (a) The commissioner may take possession of a state bank if, after a hearing, the commissioner finds:
>
> (1) Its capital is impaired or it is otherwise in an unsound condition;
>
> (2) Its business is being conducted in an unlawful or unsound manner;
>
> (3) It is unable to continue normal operations; or
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> (4) Its examination has been obstructed or impeded.
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> . . . .
>
> (c) (1) If, in the opinion of the commissioner, an emergency exists which will result

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> in serious losses to the depositors, the commissioner may take possession of a state bank without a prior hearing. Any person aggrieved and directly affected by this action of the commissioner may have a review by certiorari as provided in title 27, chapter 9.[1]

It is the Commissioner's exercise of power under T.C.A. § 45-2-1502(c)(1) that is at issue in this case. Petitioners also challenge the decision to liquidate. See T.C.A. § 45-2-1502(b)(2), T.C.A. § 45-2-1502(c)(2); T.C.A. § 45-2-1503(b) and T.C.A. §45-2-1504.

A digression into a constitutional law overview is warranted. Usually, before the government can deprive a person of property, there must be a hearing. Financial institutions have, however, traditionally been very highly regulated for obvious reasons, and federal and state regulators have been empowered to act without prior approval to take possession of troubled financial institutions in order to provide immediate protection to depositors. See, e.g., Fahey v. Mallonee, 332 U.S. 245, 67 S. Ct. 1552 (1947); First Federal Savings Bank v. Ryan, 927 F.2d 1345, 1357-58 (6th Cir 1991); Anonymous Bank v. Florida Dept. of Banking, 512 So.2d 1112 (Fla. App. 1987).

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[1] T.C.A. § 45-1-103(9) states that a deposit means a deposit of money, bonds, or other things of value, creating a debtor-creditor relationship.

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In Fahey, the court reversed a federal district court that had declared unconstitutional the seizure of a federal savings and loan association. The court emphasized that the statutes were not "penal" but "regulatory."

> They deal with a single type of enterprise and with the problems of insecurity and mismanagement which are as old as banking enterprise. The remedies which are authorized are not new ones unknown to existing law to be invented by the Board in exercise of a lawless range of power. Banking is one of the longest regulated and more closely supervised of public callings. It is one in which accumulated experience of supervisors, acting for many states under various statutes, has established well-defined practices for the appointment of conservators, receivers and liquidators. Corporate management is a field, too, in which courts have experience and many precedents have crystallized into well-known and generally acceptable standards.

Fahey, 332 U.S. at 252.

> It is complained that these regulations provide for hearing after the conservator takes possession instead of before. This is a drastic procedure. But the delicate nature of the institution and the impossibility of preserving credit during an investigation has made it an almost invariable custom to apply supervisory authority in this summary manner. It is a heavy responsibility to be exercised with disinterestedness and restraint, but in the light of the history and customs of banking we cannot say it is unconstitutional.

Fahey, 332 U.S. at 253-54. See also Hodel v. Virginia Surface Mining Reclamation Ass'n, Inc., 452 U.S. 264, 101 S. Ct. 2352, 2372 (1981).

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Assuming that the asserted facts warrant immediate intervention by the regulatory agency before a hearing can be held, then the timing of the post-seizure hearing becomes an issue. The Florida case cited above states that the financial institution is entitled to an "immediate" hearing. Anonymous Bank, 512 So.2d at 1114. The Supreme Court, while authorizing government seizures or suspensions without hearings in emergency situations, has mandated that the post-seizure hearing be "prompt" and "proceed and be concluded without appreciable delay." Barry v. Barchi, 443 U.S. 55, 99 S. Ct. 2642, 2650 (1979).

One further comment on the constitutional overlay is warranted. As one commentator has stated:

> It will always be easier for a court to uphold a post-deprivation hearing system if the individual whose property or liberty is being limited is given some pre-deprivation opportunity to respond to charges against him or to communicate with the authority who will be making the initial decision to terminate the property or liberty interest.

Rotunda and Nowak, Treatise on Constitutional Law § 17.9, p. 177-78 (3rd ed. 1999). See also Barry, 99 S. Ct. at 2649-50.

Here, the Tennessee legislature has been sensitive to the above due process concerns. As T.C.A. § 45-2-1502(c)(1) states, "any person aggrieved and directly affected by this action [the seizure of the financial institution] may have a

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review by certiorari as provided in Title 27, Chapter 9." The parties assert, and the case of Tennessee Real Estate Comm'n v. Potts, 428 S.W.2d 794 (Tenn. 1968), holds, that the proceeding must be had in the Davidson County Chancery Court. See also Hawkins v. Tennessee Dept. of Correction, 127 S.W.3d 749, 757-58 (Tenn. Ct. App. 2002). The decision to liquidate is also reviewable by petition for writ of certiorari. See T.C.A. § 45-1-108(a).

Despite the petitioners' right to a "prompt" hearing the Court did not hear proof from the petitioners that Sentinel was solvent, on a decent financial foundation, and that the Commissioner had made a significant mistake in exercising his power and taking possession until over ten (10) months after the May 2004 seizure. To explain this delay, the Court must chronicle both pre-seizure and post-seizure events.

I. BACKGROUND

(1) The record in this case indicates that since 2000, the Commissioner has been concerned about the financial well-being of Sentinel Trust Company, and in April 2004, the Department was of the opinion that the company had a net cash shortage in excess of $5,000,000.00. This concern led to a number of meetings and correspondence between the Commissioner and executives and lawyers from Sentinel.

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2. On May 3, 2004, the Commissioner issued a cease and desist order pursuant to T.C.A. §47-1-107(a)(5), requiring certain financial actions by Sentinel. The petitioners subsequently filed an administrative appeal of the cease and desist order. Events have long since passed that stage, however, and the administrative appeal is long since moot.

3. On May 18, 2004, the Commissioner took emergency possession of Sentinel pursuant to T.C.A. §§ 45-2-1502(b)(1) and (c)(1). The receivership was filed in the Lewis County Chancery Court as case number 4781.

4. On May 18, 2004, the Commissioner appointed Receivership Management, Inc. to act as receiver. See T.C.A. § 45-2-1502(b)(2)..

5. In June 2004, Department personnel issued a report stating that Sentinel had a deficiency in excess of $7,500,000.00 and that Sentinel was operating at a loss and had corporate assets of only around $1,400,000.00. The report concluded that Sentinel was insolvent.

6. On June 18, 2004, in light of the above and pursuant to T.C.A. §§ 45-2-1502(c)(2) and 1504, the Commissioner issued a Notice of Liquidation of Sentinel Trust Company. The notice was filed in the Lewis County Chancery Court as part of the already-

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filed receivership proceeding. That notice recites the factual contentions of the Commissioner and concludes:

> Accordingly, the Commissioner has determined that liquidation of Sentinel Trust Company in accordance with the provisions of Tenn. Code. Ann. §§ 45-2-1502(c)(2) and 1504 is necessary and appropriate.
>
> Any person aggrieved or directly affected by the Commissioner's determination to liquidate Sentinel Trust Company may have judicial review in Davidson County Chancery Court by common-law writ of certiorari, as provided in Title 27, Chapter 9 of Tennessee Code Annotated, pursuant to Tenn. Code Ann. § 45-1-108(a).

6. On June 29, 2004, the petitioners filed this complaint, titled "Petition for Writ of Certiorari and for subsequent Writ of Supersedeas."

7. On July 16, 2004, the petitioners filed a "Motion For Expedited Hearing on Petition For Supersedeas," requesting a hearing be set and that a writ of supersedeas be issued after the hearing. The motion by petitioners sought the writ of supersedeas because "Sentinel Trust Company is not a bank, and has none of the characteristic attributes of a bank" and because the statutory powers the Commissioner exercised apply only to a bank; the Commissioner therefore had acted "illegally" and "wholly outside his administrative and policing authority." The motion further stated that "unless the writ of supersedeas shall be issued promptly to nullify the respondent Commissioner's past

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illegal acts, he soon will have succeeded in destroying Sentinel Trust Company." The petitioners recited "the urgency of need for nullification of the Commissioner's arbitrary and illegal orders by supersedeas, so that its business may again be operated by its knowledgeable staff pending final determination." The request for supersedeas did not allege that there was no factual predicate for the seizure. It alleged only that the Commissioner had no statutory authority to do what he did.

8. Because of a scheduling problem, the Chancellor of Part I referred the July 16, 2004 motion to the undersigned to sit by interchange, and by order entered August 2, 2004, the Court set the motion for writ of supersedeas for a hearing on August 5, 2004.

9. Prior to the August 5, 2004 hearing, the Court met with counsel and offered to consolidate the hearings on the request for supersedeas with the review by certiorari and schedule it within 7-10 days so that all issues before the Court could be resolved. The Commissioner's lawyer indicated that she thought the Commissioner would agree to stop the liquidation until a final hearing, but counsel for petitioners stated that he wished to proceed on his immediate request for writ of supersedeas as he was convinced that the Commissioner was acting beyond his statutory authority.

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10. The hearing on August 5, 2004 went forward, but at the petitioners' request, solely on their argument that the Commissioner had no statutory authority over trust companies. As the Court said at the time, the petitioners refused to enter the "factual fray." The petitioners were so adamant as to their legal position that they refused to make any other argument other than the legal one.

11. On August 8, 2004, the Court issued a twelve-page memorandum and order holding that the Commissioner did have statutory authority over state trust companies.

12. The petitioners sought an interlocutory appeal, which was denied by the Court of Appeals on September 1, 2004.

13. The petitioners next turned to the federal courts. Here again, the petitioners asserted that the Commissioner had no statutory authority over trust companies. The federal court opinion contains a detailed chronology of the facts leading to the Commissioner's seizure of the trust company. It notes on several occasions that the petitioners failed to avail themselves of the opportunity to make factual challenge to the Commissioner's actions. The federal court dismissed petitioners' claim. See Sentinel Trust v. Lavender, 2004 U.S. Dist. LEXIS 27259 (M.D. Tenn. Dec. 13, 2004).

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14. On March 4, 2005, the petitioners finally moved for a status conference regarding setting the case for a final hearing. The Court met with counsel on March 16, 2005, and, by order entered that date, set the case for hearing on March 29, 2005. Although review by certiorari is usually circumspect and limited to the record, in order to ensure that the hearing held by the Court fully complied with due process requirements for a post-seizure hearing, the Court allowed the petitioners to present witnesses. The Commissioner had obviously gathered information and made a record before he took action and that record was forwarded to the Court, although the Commissioner did not formally take evidence. If an initial factual determination in an administrative proceeding is made by a person who has both enforcement and fact-finding duties and who also compiles the facts, then due process requires that the persons whose rights are subject to the process be given a de novo hearing and the right to present his own evidence. See Rotunda and Nowak, Treatise on Constitutional Law §17.8, p. 103 (3rd ed. 1999). See also Cyphers v. United Parcel, 3 S.W.3d 698 (Ark. 1999)(violation of due process to refuse to issue a subpoena requested by a party in order to permit the party to cross examine the witness and possibly present material evidence that

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might impeach not only the testimony, but the findings made by the agency as well).

II. HEARING ON MARCH 30 AND APRIL 1

The hearing was conducted on the multi-volume record filed by the Commissioner as well as the four (4) witnesses presented by the petitioners and other marked exhibits. The witnesses were:

(1) David Lemke, a Nashville lawyer who previously represented Sentinel in its negotiations with the Commissioner until shortly before the Commissioner took possession of Sentinel.

(2) Robert Whisenant, a CPA who offered testimony regarding the financial health of Sentinel at the time of the seizure.

(3) Beverly Horner, a CPA who participated in the last effort to audit Sentinel.

(4) Danny Bates, president and principal owner of Sentinel.

A. COMMISSIONER'S PROOF

The Commissioner's proof is contained in the voluminous record. The Court quotes the findings in the federal court opinion because it contains a good, accurate summary of the proof and position of the Commissioner.

> On November 20, 1975, Sentinel was chartered under the Tennessee General Corporation Act to engage in general trust company business. By law, Sentinel was not subject to the provisions of the Tennessee Banking Act or to regulation by the Tennessee Commis-

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sioner of Financial Institutions at the time of its charter. Sentinel operated for more than twenty years at various offices in Nashville, Tennessee.

Effective July 1, 1999, the General Assembly amended the Tennessee Banking Act to extend application of the banking statutes to trust companies, including those, like Sentinel, that had been chartered before 1980. Tenn. Code Ann. § 45-1-124 (2000). Specifically, the legislature provided in the amended statute that, "[u]nless the commissioner determines otherwise, the provisions of chapters 1 and 2 of this title, and the rules thereof, shall also apply to the operation and regulation of state trust companies and banks whose purposes and powers are limited to fiduciary purposes and powers." Tenn. Code Ann. § 45-1-124 (b). The amendment further provided that the Commissioner could allow trust companies a period of up to three years from July 1, 1999, to establish full compliance with Chapters 1 and 2 of the Tennessee Banking Act and the regulations promulgated thereunder. Tenn. Code Ann, § 45-1-124(h). Also, the Commissioner was given authority to conduct examinations of any trust company at the company's expense and to apply the requirements of Chapter 1 and 2 to trust companies. Id.

After these amendments took effect, state examiners conducted an initial visitation at Sentinel on October 22, 1999. The examiners identified certain violations of the Tennessee Banking Act which they discussed with Sentinel's President, Danny Bates. Thereafter, state examiners conducted three full-scope examinations of Sentinel in the years 2000, 2001, and 2002. At each of these, state examiners identified particular shortcomings that were discussed with Sentinel's Officers and Directors. While Sentinel improved over time in certain areas of its operations that examiners had criticized, its performance declined in other areas, to the consternation of the state examiners. Of particular concern to the examiners were the number of bond issues held by Sentinel as fiduciary that were in overdraft status and Sentinel's commingling bond and corporate funds. It was during this period that Sentinel built

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a new building and moved all of its operations to Hohenwald, Lewis County, Tennessee.

The fourth full-scope examination commenced June 13, 2003. Additional concerns arose during the examination. By September 2003, the examiners notified the Assistant Commissioner of the Department of Financial Institutions that Sentinel was believed to have a significant fiduciary shortfall. As a result of their report, the examination was interrupted to allow completion of Sentinel's 2002 audit.

On October 6, 2003, the Defendant met personally with Sentinel's Board of Directors to discuss issues and concerns relating to the examination, During this meeting, President Bates admitted that Sentinel used commingled funds from various bond issues to pay the expenses on other non-related defaulted bond issues. At this meeting, the financial condition of the company was discussed. The Defendant reminded the Directors that Sentinel was in violation of state statute and department regulation in that its 2002 audit had not been conducted. Further, the Defendant expressed concern that one auditor Sentinel had hired to conduct the 2002 audit had resigned and Sentinel appeared to be taking an undue period of time to hire a replacement auditor.

Continuing efforts [were] made by Sentinel to obtain an audit and by the examiners to reconcile Sentinel's books through late 2003 and into 2004. The examiners were hampered by Sentinel's use of two different accounting systems which were not reconciled to each other or to bank statements. Ultimately, in light of several significant concerns, Sentinel's auditor would not express an opinion on the financial statement of Sentinel as of December 31, 2002.

In light of this, state examiners conducted further visitations at Sentinel in March and April 2004. Based upon [the] record Sentinel provided, examiners believed that a significant net fiduciary cash shortage existed that Sentinel could not explain.

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In early April 2004, the Defendant sent Sentinel a letter requesting an attorney opinion justifying the legal basis for Sentinel's practice of "borrowing" funds generated by one bond issue to pay the expanses of another. In mid-April Sentinel's bank letter of credit for insurance purposes expired. On April 20, 2004, Sentinel's attorneys refused to give the opinion letter the Defendant had requested.

Sentinel's Executive Vice President and two attorneys representing Sentinel then asked to meet with the Defendant and his staff on April 28, 2004. Sentinel requested permission to continue using funds from the commingled fiduciary cash account to meet immediate cash needs on bond issues. Sentinel also asked to transfer fiduciary positions on two bond issues to successor trustees. The Defendant denied both requests. However, Defendant stated he wanted to meet with the Board on Friday, April 30, 2004, and would be requesting an immediate capital injection.

On April 30, the Defendant and his staff met with Sentinel's full Board of Directors. During that meeting, President Bates admitted that Sentinel then had a fiduciary cash shortfall of $ 7.25 million. The Defendant responded that he would issue an Emergency Cease and Desist Order on Monday, May 3, 2004, requiring an infusion of $ 2 million in capital as a showing of the Board's good faith and commitment to operation of the company. The Defendant also indicated that he and his staff would work with Sentinel's Board of Directors to allow it to eliminate the cash deficit over time under an approved capital plan, if the Directors would make the required infusion of capital.

Late on the afternoon of May 3, 2004, Sentinel's management submitted a capital plan to the Defendant, but then immediately withdrew it on advice of counsel. That evening, at 5:50 p.m., the Defendant issued an Emergency Cease and Desist Order, copies of which were hand-delivered to Sentinel's counsel and sent by overnight courier to Sentinel's Board of Directors.

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The Emergency Cease and Desist Order included four charges stating that Sentinel was operating in an unsafe and unsound manner (1) by using pooled fiduciary funds to provide operating capital for non-related defaulted bond issues, which created a fiduciary cash shortfall that changed on a daily basis and greatly exceeded Sentinel's then-current operating capital, (2) by operating with an inadequate level of capital for the kind and quality of accounts held under administration, (3) by failing to reconcile fiduciary cash and corporate cash accounts in a timely and accurate fashion, and (4) by failing to keep accurate books and records. The Order directed Sentinel, its Directors, officers, employees, agents, successors and assigns to cease and desist from engaging in numerous delineated acts with regard to operations, and further ordered them, among other things, to make an initial capital infusion of $ 2 million in cash by the close of business on May 17, 2004, and to submit a capital plan to completely replenish the fiduciary pooled demand deposit account.

Sentinel then obtained new legal counsel after the attorneys who had been representing Sentinel withdrew from representation when President Bates refused to resign his position with Sentinel. The new attorneys, who have substantial experience in the operation of financial institutions, communicated with the Defendant and members of his staff numerous times in the following days in an attempt to avoid the necessity of placing Sentinel in receivership. On May 17, 2004, the Defendant and his staff met with Sentinel's counsel, who reported that Board members did not have sufficient funds to meet the required capital infusion.

As a result, on May 18, 2004, effective at 10:00 a.m., the Defendant took emergency possession of Sentinel by posting at Sentinel and filing in Lewis County Chancery Court at Hohenwald, Tennessee, a Notice of Possession of Sentinel Trust Company, pursuant to Tenn. Code Ann. § 45-2-1502(b)(1) & (c)(1) . Among its provisions, the Defendant's Notice specifically stated:

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> Any person aggrieved or directly affected by the Commissioner's emergency possession of Sentinel Trust Company may have judicial review in Davidson County Chancery Court by common-law writ of certiorari, as provided in Title 27, Chapter 9, of Tennessee Code Annotated.

The Defendant also entered an Order appointing Jeanne Barnes Bryant/Receivership Management, Inc., to serve as Receiver under Tenn. Code Ann. § 45-2-1502(b)(2).

Sentinel again obtained new counsel. On June 2, 2004, Sentinel and its Board of Directors filed with Defendant their "Respondents' Special Appearance, Statement of Special Defenses, and Answer to Notice of Charges." Sentinel and its Directors emphatically contended that the Defendant lacked any power or jurisdiction under the Tennessee Banking Act to take emergency possession of Sentinel, a trust company. Without waiving this position, Sentinel responded directly to each charge the Defendant had made in the Notice of Possession and demanded "every hearing and other procedural safeguard" to which it was entitled.

The next day, June 3, 2004, having received Sentinel's demand for a hearing, the Defendant filed a request for an assignment of an Administrative Law Judge to hear the contested case. On June 16, 2004, the assigned Administrative Law Judge contacted counsel for the parties by letter, in which he set forth pre-hearing procedures to be followed and then stated "When you are ready to set a hearing date, please call me so we can pick a mutually acceptable time." According to the record before the Court, Plaintiffs did not, at any time, ask the Administrative Law Judge to set a hearing date, and Plaintiffs did not state otherwise at the hearing before this Court.

On June 17, 2004, the Defendant, members of his staff, and legal counsel met with Plaintiff Bates and Sentinel's attorney and gave them the opportunity to review a draft report prepared by the state

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examiners and the Receiver concerning the insolvency of Sentinel. The Defendant permitted Plaintiff Bates and his attorney to take this draft report into a private room to review it for about one hour. The Defendant stated that he wanted the report to be accurate and asked Plaintiff Bates and his attorney to point out any inaccuracies or any other concerns they might have.

The draft report reflected that, as of December 31, 2003, Sentinel had a shortfall in the pooled fiduciary account of $ 5,789,011.00. The report also showed that the shortfall increased over the next four months so that, by May 18, 2004, the deficiency ranged from $ 7,612,218.00 in one accounting system used by Sentinel to $ 8,430,722.00 in the fiduciary account system. Further, the Receiver had discovered bond principal and interest checks totaling $ 861,107.11 in Sentinel's vault that had not been sent to bondholders. The report also showed, based on Sentinel's records, that for the first four and one-half months of 2004, it operated at a net loss of $ 197,917.00. Sentinel had total corporate assets of $ 1,389,683. Thus, considering the cash deficiency in the pooled fiduciary account, Sentinel was insolvent in an amount of at least $ 6,225,445 as of May 18, 2004.

After reviewing the report, Sentinel's attorney pointed out a typographical error in the report and stated he would like to submit written comments the following morning. The attorney made other observations about matters concerning the Receiver's operations. A few changes were made to the report as the result of the meeting, and then the final report was provided to the Defendant. The next morning, June 18, 2004, Sentinel's attorney and Defendant's counsel had several conversations about the submission of Sentinel's written comments, but ultimately Sentinel did not submit any. It appears that Sentinel did not, at any time, inform the Defendant of any errors noted in the draft report.

Upon consideration of the final report, the Defendant decided that Sentinel should be liquidated. Early on the afternoon of June 18, 2004, Defendant

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> filed a Notice of Liquidation in the Lewis County Chancery Court proceeding, pursuant to Tenn. Code Ann. § 45-2-1502(c)(2). The Notice stated the reasons why the Defendant had determined liquidation was necessary and indicated the Defendant would proceed to liquidate Sentinel pursuant to Tenn. Code Ann. § 45-2-1504. The Notice of Liquidation provided that "[a]ny person aggrieved or directly affected by the Commissioner's determination to liquidate Sentinel Trust Company may have judicial review in Davidson County Chancery Court by common-law writ of certiorari, as provided in Title 27, Chapter 9 of Tennessee Code Annotated, pursuant to Tenn. Code Ann. § 45-1-108 (a)." Since June 18, the Defendant and the Receiver have proceeded to liquidate Sentinel, and they have made filings with the Lewis County Chancery Court seeking permission to take certain actions with regard to that liquidation.

Sentinel Trust, 2004 U.S. Dist. LEXIS 27259, at *6-18. The federal judge stated that the above facts were the "written factual record submitted by the parties." Id. at *6. The record in this case fully supports the facts stated above.

In addition to the above, the Commissioner emphasized part of his cease and desist order issued several weeks prior to the seizure:

> In response to the April 5, 2004 letter, Sentinel's counsel requested a meeting with the Commissioner. On April 28, 2004 Sentinel's Executive Vice President Paul Williams and Sentinel's attorneys Alex Buchanan and David Lemke met with the Commissioner. At this meeting, counsel for Sentinel indicated that the practice of funding defaulted bond expenses with funds from other non-related bond issues was inappropriate. They indicated that the expenses attributable to defaulted bonds are typically funded with corporate assets.

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At the April 28, 2004 meeting, counsel, on behalf of Sentinel, requested permission for Sentinel to continue on a temporary basis the practice of "borrowing" funds from one bond issue to cover the expenses of unrelated defaulted bond issues. The Commissioner declined to approve the request.

Counsel for Sentinel also stated at the April 28, 2004 meeting that Sentinel's fiduciary cash shortfall is believed to be between $8-10 million.

On April 30, 2004 the five members of Sentinel's Board and their counsel met with the Commissioner. At that meeting President Danny Bates stated that Sentinel's most recent calculations show that Sentinel had a deficit fiduciary cash position of seven million two hundred fifty thousand dollars ($7,250,000). However, Mr. Bates indicted that this figure fluctuates daily. Finally, Mr. Bates stated that Sentinel's corporate cash account had a current balance of fifty three thousand dollars ($53,000). The Department believes that the amount of cash is inadequate to pay the operating capital needed for the administration of the defaulted bonds for the immediate future.

These events were then followed by a letter from Sentinel's own lawyer to the Board of Directors on May 6, 2004, as follows:

As counsel to Sentinel Trust Company, we feel we need to address an issue with you as Board members. Please keep in mind that our advise is intended as what we believe to be the best interests of the Company, which may not be in the best interest of the Board members. In that regard, it is our conclusion that it would be in the best interest of the Company for the current Board members, other than Danny, to ask Danny to resign as an officer and director of the Company. If he does not do so voluntarily, we will have to resign as counsel to the Company and we recommend that the remaining Board

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members consult independent counsel as to the course of their own actions.

> We do not make this recommendation lightly, but we do so having due regard for the circumstances that Sentinel finds itself and in light of the implications of the Cease and Desist Order. Assuming Danny resigns, the remaining Board should immediately appoint an independent person(s) to take the lead on handling Sentinel's affairs until further action is taken by the State. If this plan is one that the Board is willing to implement, please keep in mind that the Cease and Desist Order requires the Commissioner's approval before there is change in management. Therefore, it would be imperative to identify the person(s) that Sentinel proposed to handle Sentinel's affairs upon Danny's resignation and to receive the Commissioner's prior consent to that management change. Please let me know if this is a plan that the Board is willing to adopt. We ask for a reply by the close of business on May 10, 2004.

The Board did not act on this recommendation nor was there an infusion of cash. Mr. Lemke resigned only to be replaced by lawyers from Miller & Martin. Those lawyers were no more successful in having their client, Sentinel, follow their recommendations. See Exhibit 28, letter from Mary Neil Price to The Department. When the seizure took place, the Miller & Martin lawyers also withdrew.

B. PETITIONERS' PROOF

The petitioners' first called David Lemke as a witness. Mr. Lemke is an attorney for the Waller Lansden law firm, which the petitioners describe in their petition as "a firm of high

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professional reputation, standing and abilities." Petition ¶ 27.[2]

Mr. Lemke testified that he had represented Sentinel for a number of years but in matters unrelated to its relationship with the Commissioner. He was not consulted by Mr. Bates on the regulatory matters until April 2004. At the request of Mr. Bates, he looked into Sentinel's use of the pooled trust funds and concluded that Sentinel's use of these funds was inconsistent with industry standards and that he could not render an opinion that it was legal given his understanding of the custom in the industry. Mr. Lemke also noted that in April 2004, he became aware of the 6-8 million-dollar shortfall in accounts regarding defaulted bond issues. When he made inquiries of Mr. Bates about the shortfall he got an explanation that made "no sense." He then recommended that Mr. Bates resign because Sentinel needed an "honest broker" and that Mr. Bates had "issues." Mr. Lemke said he could get no rational explanation from Mr. Bates about the shortfall. He further stated that he thought that Sentinel was under-capitalized on the corporate side. Sometime in early May 2004, he ceased to represent Sentinel.

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[2] However, in their administrative complaint, the petitioners state that Waller Lansden lawyers were "neither qualified nor competent to express opinions on accounting matters." (Record 00575).

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The Court is not certain why Mr. Lemke was called by the petitioners as his testimony appeared to corroborate the Commissioner's proof and was not helpful to the petitioners.

The petitioners second witness was an accountant, Mr. Robert Whisenant. Mr. Whisenant stated that Sentinel was not insolvent when the Commissioner took it over in May 2004. By the three (3) most important measures, Sentinel was viable. It continued to make its bond payments. It continued to pursue defaulters. It was making collections. He described Sentinel as a "moving target" because in this kind of business everything is "timing." It is common to rely on future income, go through cycles, and have trouble with cash flow. Given the above, he thought there was no way it could be considered insolvent.

As to the pooled trust account, Mr. Whisenant could not say whether Sentinel's use of it was appropriate. He admitted it that was beyond his expertise, but as far as he knew, it was proper. He also thought that Sentinel's accounting consideration of the fees and monies used from this account for collection against defaulted issues was appropriate and was an asset.

The third witness was accountant Beverly Horner. Ms. Horner worked on the 2003 audit of Sentinel for Kraft, Inc. The audit was never completed as Kraft could never verify the account receivables and there were continuing problems about commingling

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the trust and corporate accounts. See Exhibits 9 and 10. Just like Mr. Lemke, this witness seemed to help the respondent more than the petitioners.

The fourth witness was Mr. Danny Bates. Mr. Bates purchased Sentinel beginning in 1986. He related how recent cash flow problems were the result of the so-called Namer bond issue failures as well as recent problems in the health care industry. He felt that by late 2003, he had successfully worked out most all of the defaulted bond issues and that he had bonds in the books that would have continued to generate fees for years to come.[3] He responded to criticism that he had failed to report a sizeable Chancery Court judgment by saying that the judgment was reported and that the judgment was resolved by a settlement that Mr. Bates personally paid by making a gift to Sentinel.

Mr. Bates insisted that the Commissioner's concerns of the cash shortfall were based on the Department's misunderstanding of the collected practices of his business and its accounting methods. He stated that there was no reason that given the cash flow of the business, the problems could not be worked out and that he was prepared to follow all the recommendations of the

[3] The record reflects that one point, that the company was administering 143 bond issues, 26 of which were in default or in a "workout situation."

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Commissioner except for the suggestion of the infusion of $2,000,000.00 in cash.

On the one hand, he testified that Sentinel's use of the pooled trust account to fund collection of defaulted bond issues was proper, but on cross examination, he admitted that the bond indenture agreement "probably" prohibits the use of bond payments being used to collect for other bond issues. Further, he testified that he was little concerned by the failure of his accountants to complete audits in 2002 and 2003. The confusion over the receivables by his hired auditors seemed to be of small import. As already noted, he insisted that the concerns of the Department over the co-mingling of funds with reference to the pooled trust account and the so-called shortfall was based on a misunderstanding regarding the intricacies of the trust business, the administration of the bond issues, bond defaults, and fee collection. Mr. Bates agreed with Mr. Whisenant that Sentinel was not insolvent and that it continued to make its bond payments, make collections, and pursue defaulters.

Perhaps a good summary of Mr. Bates' position as to the accounting problems is found in the petitioners' administrative complaint:

> Respondent Company Sentinel admits that its Board met with the Commissioner and others on April 30, that its President Bates answered that the sum of cash overdrafts in defaulted trust accounts and prior

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overdrafts then being carried as a receivable on the Trust Department books and records was an estimated approximately $7.25 million. Said Respondent further alleges that the fees and expenses cumulatively paid to its Counsel equaled more than half of the overdrafts and receivables incurred in its performance of its duties to the bondholders of defaulted bonds; that its method of accounting and funding fees and expenses for defaulted trust accounts had not changed from the time the Department first began its examinations in 1999 and that until the present time the Department had not instructed or advised Sentinel that its policies and procedures were not acceptable. Said Respondent further alleges that the Department knew or should have known about these matters since Sentinel obeyed the Department's requirements that it file monthly reports with the Department from November, 2000 to July, 2001, and that it thereafter filed quarterly reports continuing through and up to April 30, 2004.

Record 00575-76.

III. FINDINGS

1. This Court was always open and ready to grant the petitioners a prompt post-seizure and/or post-liquidation notice hearing. The failure to have a prompt post-seizure hearing challenging the factual basis for the seizure was entirely the fault of the petitioners. Petitioners' counsel in August, 2004 insisted that his legal arguments were so strong that he did not need a hearing on the facts. He insisted on a hearing limited to his argument that the banking statutes did not apply to trust companies. See Memorandum and Order of August 9, 2004. This insistence was pressed in the face of the Court's offer to give

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him a final hearing on all issues within 7-10 days of August 5, 2004. When petitioners lost their legal argument in state court, they were so sure of their position that they then went to federal court where they again lost. Finally, having failed to win on their legal argument, petitioners finally in March 2005, ten (10) months after the Commissioner took possession, requested a hearing challenging the Commissioner's factual determinations.

2. The Court continues to adhere to its decision expressed in its memorandum and order of August 9, 2004 that the banking statutes apply to trust companies and that the statutory structure allowing the Commissioner to take possession pursuant to T.C.A. § 45-2-1502(c)(1) and related statutes is constitutional. The memorandum and order of August 9, 2004 is incorporated herein.

3. The factual challenge to the Commissioner's action has been delayed so long by the petitioners that this case is now moot. See Boyce v. Williams, 389 S.W.2d 272, 277-78 (Tenn. 1965). The receivership and liquidation have proceeded now for eleven (11) months, and the record indicates that Sentinel is but an empty shell. While Humpty Dumpty could perhaps have been put back together in the Summer of 2004 it can no longer be put

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back together. As the Court stated in Boyce in considering an analogous situation:

> Should we now grant the relief sought, and remand the case to the trial court for trial it would only amount in further delay.
>
> University has now been merged with a foreign corporation and we dare say most, if not all, its assets are in a foreign state and out of the jurisdiction of the courts of this state.
>
> Thus, the courts of this state cannot grant to appellants any effectual relief and to now remand the case for a trial would be a useless gesture on our part. The question of whether the commissioner's approval of the merger should be vacated and whether appellants are entitled to an injunction and a segregation of the assets of University as prayed for in the petition have become moot.
>
> . . . .
>
> Where it appears the act to be enjoined has been consummated, an action for an injunction presents only a moot question and will be dismissed. The judgment of the trial court dismissing the petition for a writ of certiorari and supersedeas is affirmed.

Boyce, 389 S.W.2d at 277-78.

4. If the Court were to reach the factual merits, the Court would affirm the actions of the Commissioner. There is an argument that Sentinel's condition fell short of an "emergency" as it was still operating, although its capital was "impaired" and it was being conducted in an "unsound manner" and therefore, the Commissioner could have used T.C.A. § 45-2-1502(a)(possession after hearing) rather than (c)(1)(possession

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without a prior hearing). The Court also is aware that the petitioners and their lawyer are convinced that the Commissioner has acted wrongfully in taking possession and then moving to liquidate. One former employee even termed the Commissioner's actions to be "malicious and vindictive." (Record at 00495).

The Court is of the opinion, however, that when administrators deal with financial institutions there is little ground for half measures. The Board had failed to act on the Lemke recommendations nor had the cease and desist order produced results. Furthermore, given the June 2004 report of the receiver and the failure of Mr. Bates and the Board to respond to the report, the decision to liquidate is supported by the record. In resolving the significant differences between the Bates/Whisenant view of Sentinel's economic viability and the Commissioner and his auditors, the Court places special emphasis on three (3) points:

a. The lawyers. The lawyers for Sentinel in April and May 2004 were experienced commercial lawyers with knowledge of trust companies' obligation to its bond holders and its financial operations. None of the lawyers expressed any doubt as to the Commissioner's understanding of Sentinel's condition in relation to the shortfall or the use of the pooled trust account. None of the lawyers took the position that the Commissioner was

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acting arbitrarily or without good reason. Indeed, Mr. Lemke testified that he found Mr. Bates unable to rationally explain most of the shortfall, and he expressed great concern about Sentinel's use of the pooled trust funds for an unauthorized purpose. The opinions and actions of the Waller Lansden and then the Miller & Martin lawyers is consistent with the Commissioner's view of the financial condition of Sentinel and inconsistent with the Bates/Whisenant view.[4]

b. The record shows that up until several months after the Commissioner took possession, Mr. Bates did not take issue with the Commissioner's recommendations or opinion as to the financial health of Sentinel. Mr. Bates actually appears to agree, at least implicitly, with the Commissioner's assessment up through and including the receiver's first report in June 2004. There is nothing in the record to indicate that Mr. Bates or his lawyers ever told the Commissioner in writing or orally that he did not understand the trust business, the way it operated, its accounting standards, or that the Commissioner was mistaken and about to make a terrible mistake.

c. The Court finds the McCullough affidavit especially enlightening. The facts set out therein are creditable and

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[4] Specific comments by the Miller & Martin lawyer are at 00454-55 of the record and in several correspondence found in the record.

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consistently supported by the entire record. (Exhibit 31 - 8 pages).

All this leads the Court to conclude that the facts support the conclusion of the Commissioner that an emergency existed and that the money in the pooled trust account belonging to the bond holders was in immediate threat if he did not act. The record further supports his decision to liquidate.

IV. CONCLUSION

For the reasons expressed above, the petition for a writ of certiorari is denied. This case is dismissed, and the costs are taxed to the petitioners. This is a final order disposing of all issues before the Court.

This the 13 day of April, 2005.

WALTER C. KURTZ, JUDGE
BY INTERCHANGE

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